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746850—47

In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 1339

HELEN A. DEGUIRE, AS EXECUTRIX OF THE LAST WILL AND TESTAMENT OF GEORGE N. DEGUIRE, DECEASED, PETITIONER

v.

JOSEPH T. HIGGINS, COLLECTOR OF INTERNAL REVENUE OF THE UNITED STATES FOR THE THIRD DISTRICT OF NEW YORK

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 123–127) is reported at 65 F. Supp. 445. The opinion of the Circuit Court of Appeals (R. 134–141) is reported at 159 F. 2d 921.

JURISDICTION

The judgment of the Circuit Court of Appeals (R. 141) was entered on February 11, 1947. The

petition for a writ of certiorari was filed on May 6, 1947. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the court below erred in holding that dividends paid during the taxable years constituted, on the facts here involved, gross income of the petitioner under Section 22 (a) of the Revenue Act of 1936.

2. Whether assessment of the taxes involved for the taxable year 1936 was barred by Section 275 of the Revenue Act of 1936 at the time the assessment was made.

STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> * * * * *

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this title shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * * *

(c) *Omission from Gross Income.*—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

* * * * *

SEC. 276. SAME—EXCEPTIONS.

* * * * *

(b) *Waiver.*—Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

STATEMENT

This is a suit against the Collector of Internal Revenue for the Third District of New York to recover the sum of $45,453.61, with interest, paid by the estate of George N. DeGuire, deceased, as additional federal income taxes and interest upon income of the decedent for the taxable years 1936 and 1937. The facts were stipulated (R. 24–34), and are not in controversy (Pet. 2).

George N. DeGuire, deceased (herein sometimes referred to as the decedent), Mrs. Fay Harvey Moore, Charles H. Bosworth, John H. S. Lee, and G. M. Ludlow, owned all of the 10,000 shares of the capital stock of Ajax Hand Brake Company. The decedent and Mrs. Moore each owned 4,000 shares and the other 2,000 shares were divided among the other three. (R. 30, 134.) On December 31, 1935, Mrs. Moore, Bosworth, and the decedent (Lee having already agreed to sell his shares to the decedent) entered into a contract by which Mrs. Moore and Bosworth agreed to sell their shares to the decedent. (R. 29, 38–43, 134.) Under the agreement the decedent paid to Mrs. Moore in cash at the time of execution of the contract the sum of $43,904 of the total price of $96,000 which he agreed to pay for her 4,000 shares, and executed four promissory notes, all dated December 31, 1935, one for $17,365, payable on December 31, 1936, two for $8,682, payable on December 31, 1937, and the fourth for $17,367,

payable on December 31, 1938. All were also payable earlier at the decedent's option, and interest ran at the rate of five percent per annum, payable semi-annually. Mrs. Moore agreed to attach a certificate for 1,332 shares of stock to the first note, a certificate for 667 shares to each of the second and third notes, and a certificate for 1,334 shares to the fourth note, all such certificates to be endorsed in blank. (R. 38–39, 134–135.)

The parties were to deposit the notes with the certificates attached in escrow in a bank which was instructed that upon delivery to the bank by the decedent of a certified check for the principal of any note, together with any interest accrued from the last interest date, and a receipt for the payment of all earlier interest, the bank should deliver to him the certificate to which the note was attached. In case the decedent failed to pay the principal and accrued interest on any note when the principal became due, the bank was instructed to deliver that note back to him and to deliver the certificate attached to it to Mrs. Moore. Until the decedent had paid the notes payable on December 31, 1936, and half of those payable on December 31, 1937, two of the directors of the company were to be nominated by Mrs. Moore and Bosworth and one by the decedent. Thereafter Mrs. Moore and Bosworth were to vote for such persons as directors as the decedent should nominate. The capital stock was not to be increased.

Mrs. Moore and Bosworth were to be entitled to vote upon their certificates while the bank held them. Until all the notes were paid no dividend could be declared unless the decedent approved. No officer could have a salary, and the decedent could name all of them. (R. 40–42, 135.) The contract concluded with the following clauses (R. 42, 135):

> All dividends which may be paid, during the life of this agreement, on the stock of the Ajax Hand Brake Company agreed hereby to be sold, shall be credited by the recipient thereof upon the principal and interest of the next one of the said notes thereafter to become due.
>
> It is understood and agreed that the party of the third part [decedent] shall not be personally liable under this agreement or otherwise or upon any of the said notes, and that the only remedy of the parties of the first and second parts in the event of the failure of the party of the third part to pay any of the said notes and accruing interest thereon, shall be the right to the redelivery of the certificate or certificates of stock attached thereto.

The Ajax Hand Brake Company declared a dividend of seven percent on December 1, 1936, payable on the 15th, and on that day issued a check payable to the order of Mrs. Moore for $28,000—the dividend on 4,000 shares of stock. The check was delivered to the decedent, Mrs. Moore endorsed it in blank, and the decedent de-

livered it to the bank. With the proceeds he instructed the bank to pay the note due December 31, 1936, and one of the two notes due December 31, 1937, and to apply the balance—$1,953—towards the payment of the other note due December 31, 1937. The bank thereupon delivered to him the certificate for 1,332 shares of stock attached to the note due December 31, 1936, and the certificate for 667 shares attached to that one of the notes due December 31, 1937, which was paid. (R. 32–33, 60–61, 136.)

In December, 1937, the Ajax Company declared a dividend of 12 percent on its shares and a check was issued to Mrs. Moore for $24,012 upon the 2,001 shares remaining in her name. She endorsed this check and the decedent delivered it to the bank. After the proceeds were applied to the remaining unpaid notes it left unpaid only the interest and a small sum on the principal, which the decedent paid, and the bank delivered to him the two remaining certificates for 2,001 shares of stock. (R. 33, 136.)

The payment of dividends on the stock purchased from Bosworth, and the discharge of notes given by the decedent to Bosworth, were handled in the same manner. (R. 33.)

The decedent did not report any amount in his federal income tax returns for 1936 and 1937 on account of dividends paid in those years by Ajax Hand Brake Company on its stock standing in the name of Mrs. Moore and Bosworth. The Com-

missioner determined that the payment of the dividends under the circumstances resulted in the receipt of taxable income by the decedent—$34,895 in 1936 and $29,928 in 1937—and assessed and collected the additional taxes and interest here involved. (R. 26–29, 136.) The court below, reversing a judgment of the District Court in favor of the petitioner, sustained the Commissioner's determination. (R. 134–140.)

With respect to the statute of limitations issue applicable to 1936, the decedent filed his 1936 income tax return (R. 35) on or about March 15, 1937, reporting gross income of $137,683.47 (R. 139, Br. 25),[1] but without reporting any amount on account of dividends paid in December, 1936, on stock which he purchased from Mrs. Moore and Bosworth. The dividends in question amounted to $34,895, which is more than 25 percent of the amount reported by the decedent as gross income for that year. (R. 139, Br. 25–26.) On January 17, 1940, the decedent executed a waiver extending to June 30, 1941, the period for assessing additional taxes for 1936, and on January 30, 1942, he executed a further waiver extending such time to June 30, 1943. (R. 26, 65, 69.) The additional tax in controversy was assessed by the Commissioner on August 14, 1942. (R. 26.) The court below held that the period of limitation

[1] Decedent's 1936 return (R. 35) shows gross income of $84,340.32 after deducting $53,343.15 from compensation in item 1.

is governed by Section 275 (c) of the Revenue Act of 1936, rather than by Section 275 (a) of that Act, and that the assessment was timely. (R. 138–140.)

ARGUMENT

1. Determination of the principal issues involved in this case depends upon its own particular facts. The case does not present the broad question, posed by the taxpayer (Pet. 9), whether dividends paid on stock deposited in escrow under an option agreement are taxable to the owner of the stock or to the optionee. Rather, as taxpayer admits (Pet. 2), "the case hinges upon the agreement, dated December 31, 1935," under which the decedent acquired from Mrs. Moore and Bosworth their stock in Ajax Hand Brake Company. The specific question presented is whether the dividends paid by Ajax Hand Brake Company, under the circumstances here involved, are taxable to the decedent for the years in which they were paid.[2]

Since decision of the question involved depends upon the construction of the agreement referred to, and the peculiar facts of the case, the decision below cannot be in conflict with any other decision

[2] The taxpayer makes no point here of the fact that a part of the 1936 dividend was applied on notes due in 1937 which were not, however, paid until 1937. The stock certificates attached thereto also were not delivered to the decedent until the latter year. But the court below properly disposed of this aspect of the matter. (R. 139–140.)

not involving the same contract and extraneous circumstances. Nor does the taxpayer assert any conflict of decisions as a basis for granting certiorari. (Pet. 9–10.)

On the other hand, the decision below is in complete accord with the decision of the Circuit Court of Appeals for the Seventh Circuit in *Moore* v. *Commissioner,* 124 F. 2d 991, involving the construction of this same agreement. In that case the Commissioner sought to tax Mrs. Moore, the seller, upon the same dividends which the court below has held taxable to the decedent in this case. And the opinion in that case clearly demonstrates why the agreement in question was not a mere option in favor of the decedent to purchase the stock of Mrs. Moore and Bosworth.

The substance of the taxpayer's argument on this point (Br. 16–22) is that dividends paid by Ajax Hand Brake Company in 1936 and 1937 on the stock which the decedent purchased from Mrs. Moore and Bosworth merely represented a reduction in the purchase price which he paid for their shares. In its opinion (R. 136–138) the court below correctly answered that contention. Regardless of who held the bare legal title to the shares involved, the parties had in the agreement of December 31, 1935, specifically allocated to the decedent the principal attributes of ownership together with all future dividends on those shares of stock, and the question where the title reposed,

whether legal or equitable, was relatively immaterial.

The court below properly construed the agreement of December 31, 1935, as making the decedent liable to tax on the dividends involved and there is no merit to the argument (Br. 16–22) that the dividends represented a reduction in the purchase price of the stock. They clearly represented a distribution of current earnings. See *Moore* v. *DeGuire*, 125 F. 2d 486 (C. C. A. 2d).

2. Nor does the statute of limitations issue present any grounds for granting a writ of certiorari. There is no conflict of decisions on this point, and the decision below holding that the assessment was not barred when made is correct. Answer to the question depends upon whether the three-year limitation period provided in Section 275 (a) or the five-year limitation period provided in Section 275 (c) of the Revenue Act of 1936, *supra,* applies. Section 275 (a) of the Act provides generally that an assessment shall be made within three years after the return was filed, while Section 275 (c) provides that if the taxpayer, in making his return, omits from "gross income" an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed at any time within five years from the date the return was filed. Section 276 (b) of the 1936 Act, *supra,* authorizes the taxpayer and the Commissioner to extend the assessment period, in

writing, *before* expiration of the statutory period for assessment. In this case, the so-called waivers were executed after expiration of the three-year assessment period but before expiration of the five-year assessment period and the assessment for 1936 was timely if the *full* amount of dividends—$34,895—paid on shares standing in the names of Mrs. Moore and Bosworth represented gross income to the decedent within the meaning of Section 22 (a) of the 1936 Act, *supra.*

The argument of the petitioner in this connection (Br. 22–27) is that in any event the decedent is taxable in 1936 only upon such amount as represents his "income benefit" from the payment of dividends on the shares of stock involved. She would thus eliminate the amount of such dividend applied on the payment of interest due on decedent's notes and reduce the amount includible in "gross income" below 25 percent of the amount of gross income reported in his return. There is nothing in the record to indicate whether this question was raised in the refund claim on which this suit was based. But in any event, the argument is without merit and was properly characterized by the court below as "so transparently untenable" as not to merit consideration. The argument is similar to the "effective rate" of interest argument of the Commissioner in *Old Colony R. Co.* v. *Commissioner,* 284 U. S. 552. If the dividends in question represented gross income

within the meaning of the statute—and the court below properly held them to be gross income—the full amount represented "gross income" for the purposes of Section 275 (c), *supra*, regardless of whether the portion applied to the payment of interest was deductible from gross income under Section 23 (b) of the 1936 Act.

CONCLUSION

The decision below is correct and there is no conflict of decisions. The petition should be denied.

Respectfully submitted.

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